RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

July 11, 1990 **LETTER 1047**

June 29 DJIA 2880.69; PTI 3276; A-D Ratio -10.02
July 6 DJIA 2904.95; PTI 3280; A-D Ratio -10.09
Dow Yield: 3.71%; Dow P/E: 13.9; DowPow: 379
Dow Book Value: 1075; Dow 200-day MA: 2719
Percentage of Undervalued Blue-chips: 20%
PTI 89-day Moving Average: 3260

In my humble opinion, this is the most important Letter I've written all year. So here goes ----

GATHERING STORM: I've been writing about the rising levels of debt and the danger of compounding interest probably longer than any letter writer alive. And I've been warning of the extreme danger of the situation. Let me explain a few things here at the opening of this Letter.

According to the "Flow of Funds," published by the Federal Reserve, the total US debt (all types) as of the end of 1989 was **$12.4 trillion.** In case you didn't realize it, that's a lot of debt -- A LOT!

Interest rates are now historically high, very high. When I was a boy, savings banks were paying 2.5% for deposits, and you were glad to get that. Later, in the mid-1960s, the US Treasury issued the "Magic Fives," and everybody was astounded -- 5% on Treasury bonds! At 5%, it was said, "Bonds would draw money from the moon."

Well today the Treasury is paying 8% for three-month money. And most Treasury bonds pay more. So let's get back to that $12.4 trillion total debt. At 8% (actually most of it is financed at more than 8%), it takes $992 billion a year in interest to cover that debt.

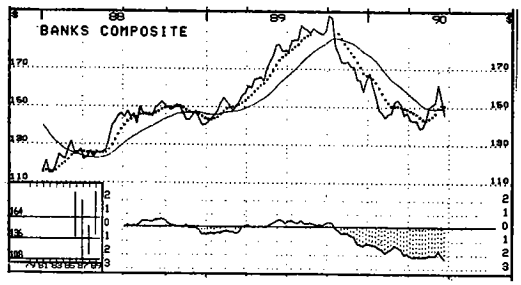
The future value of $12.4 trillion in five years is $20.44 trillion. That means that around **$8 trillion** will have to be generated and paid out to service the current $12.4 trillion in debt over the next five years. And that's assuming no new additions to debt; I'm talking about just the compounding-interest effect.

Now consider this. The broad M-4 money supply (I've shown that chart many times) is growing at the lowest rate in three decades. Today, instead of the rate of money supply rising, it's contracting! What does this mean? It means that the US is moving into a deflationary situation, a situation in which debtors are and will be increasingly squeezed. Furthermore, as the market requires more and more money to carry the huge $12.4 trillion of debt, the money is becoming increasingly difficult to find.

The results of this compounding vice are beginning to break out into the open. Retail sales are sluggish. Discount stores are taking over. Home prices are weakening. The value of many assets are declining even while the task of carrying the debt is increasing. Donald Trump found this out. Campeau found it out. The S&L industry found it out. And now some of the banks and insurance companies are discovering it.

Despite what you may think, the Fed can't expand the money supply at will. Only borrowing at the banks can do that. But the banks are worried, and loans are becoming harder to get. The banks are piling up too many "non-performing" loans. Thus, the rate of monetary growth is declining. What if the banks get really worried? If that happens the money supply could turn negative -- it could actually start contracting.

I've said this before, but I'll repeat it. All debts are either (1) paid off, (2) refinanced, which means they're pushed off to some future date, (3) reneged on, meaning they're never paid off. Right now we are seeing all three of these in action. But as the debt-compounding process speeds up and as deflationary forces increase, number three is fated to move to the fore.

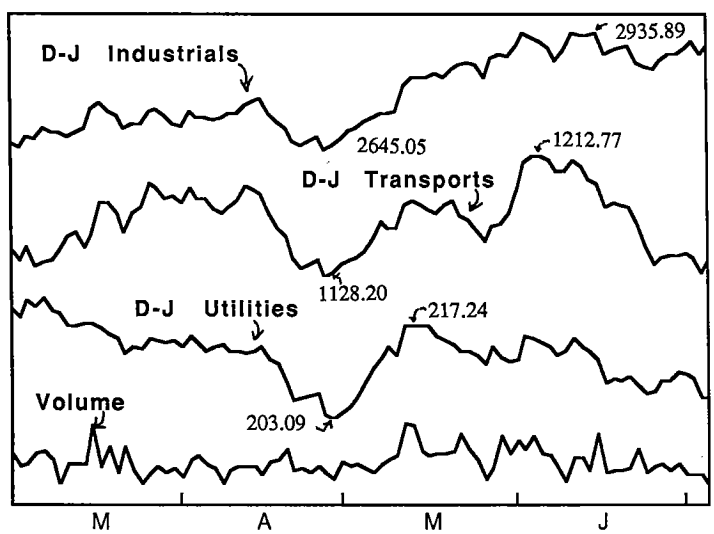


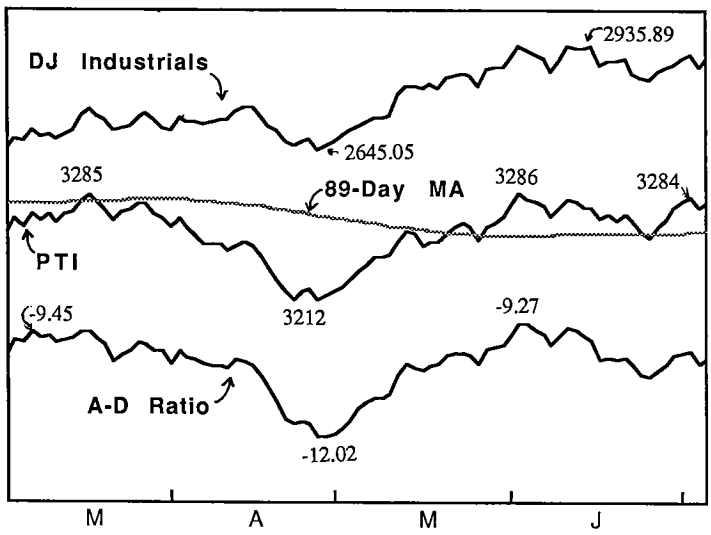
The bank stocks are not doing well today. I show here the latest *Mansfield* chart of the Bank group (lower shaded portion is relative strength). I don't like this picture; it's a bearish profile moving sharply against the trend of the Dow and the S&P 500.

Last week (as talk of Fed easing hit the news wires) the dollar (as measured by the dollar index) plunged to a new low for the year. Let that kind of action continue, and bonds will start sliding, sending long-term interest rates UP (as opposed to the widely-held opinion that interest rates are heading down).

My feeling is that this is not a time for pin-point timing, this is a time to think in terms of long-term safety. There are two convenient places to put money outside the banking system. One place is Treasury bills and the other is gold, and I happen to like gold bullion coins (although there's nothing wrong with good gold stocks or gold funds). Of course a third place is in a foreign currency such as Swiss francs or Deutsche marks.

That, in a nutshell, is the very big picture as I see it. Those are the fundamentals of the primary bear market that I believe we are now moving in to. So far, the bear has been lazy, providing only a few clues as to his intentions, clues which I discuss below. As time





goes on, however, the clues will turn into real, vicious,bear market action. But this bear is in no hurry. He'll surface in his own good time.

But the picture I presented above is the big one, the overriding one. It's the power of compounding interest rates bearing down relentlessly on rising and unsustainable debt.

THE MARKET: What are we really looking at? What kind of a market is this? Here's what I see. Today there are thousands of funds (mutual, closed-end, foreign, pension, corporate) all fighting furiously to show superior performance -- profits. Furthermore, there's a lot of money on the sidelines. *Market Logic* (3471 N. Fed. H'way, Ft. Lauderdale, FL 33306) notes, "Mutual fund liquidity has never been greater or more bullish. One out of every eight dollars managed by equity funds is in cash and equivalents, and the Fosback Index has soared to an all-time record high."

Equity funds don't like to be loaded with a lot of cash, so there's pressure on the funds to buy. Do large amounts of money on the sidelines guarantee a bull market? No, but on the other hand, you can't have a bull market without the fuel -- which is ample quantities of money.

Nevertheless, the bulls have a problem. The US is probably near the end of an unprecedented (but debt-ridden) eight-and-a-half years of economic expansion. A number of economists believe the US is in recession even now. Everyone's feeling the heat. Everyone reads about the troubles at the banks and the S&Ls, and everyone knows about Donald Trump's near-bankruptcy. And everyone knows a cousin or a neighbor who has just lost his job.

But what about the market? The market is tentative, confused, but nevertheless volatile as program traders run the averages up and down, in what now must be considered a Dow trading range. But is it a bull or a bear market? That's the big question, the question that has not been decided in the mind of the average investor.

In view of that question, let's examine the price action as dispassionately as possible. First, we note that the D-J Transportation Average recorded an all-time high of **1532.01** on September 5, 1989. Following the high, the Transports collapsed 500 points to a low of 1031.83 on January 30. Transports then rallied to a recent June 6 peak of 1212.77, following which they headed down again.

As opposed to the dismal performance of the Transports, the D-J Industrial Average rallied to a record high of **2935.89** on June 15 of this year. The new Dow high came nine months after the peak in the Transportation Average. The new Dow high produced a primary non-confirmation, accompanied by one of the widest pointage failures (on the part of Transports) in market history.

Next, the Utilities: the Utility Average was first introduced in 1929, and thus it appeared too late to be fitted into classic Dow Theory. Nevertheless, George Schaefer, the late, great Dow Theorist, gave great credence to the action of the Utility Average, and I have followed his lead. The utility stocks reflect many forces; they reflect interest rates, energy usage, oil prices, regulatory agency rulings and general activity in the economy. Therefore, the action of the Utility Average is most important in appraising the trend of the market and the economy.

The Utility Average has been called the stock market bellwether because it so often leads the rest of the market (although the lead time tends to be a long one). At any rate, the D-J Utility Average recorded its bull market high of **236.23** on January 1, 1990. It then turned down, and of late this Average has been a decided laggard. Currently, (see page 1 chart) the Utility Average is in the 206 area, well below its January record high.

Next, we have the action of the advance-decline ratio, an unweighted index which I use as a proxy for the general market. The A-D ratio recorded a peak of minus 5.49 last August 8. It has been in a steady decline ever since. The low was hit (minus 12.02) on April 30. As of this writing the A-D ratio is roughly two points above its April low, and acting rather poorly.

Finally, I'll turn to my proprietary indicator, the Primary Trend Index (PTI). The PTI (see page 2 chart) broke out above its 89-moving average (MA) on May 23, and rallied to a peak of 3286 on June 4. From there the PTI declined to exactly touch its MA (while still remaining bullish) on June 26. As this is written, the PTI has advanced to 3284 -- within two points of its June 4 peak. The PTI has been in the bullish mode since May 23.

CONCLUSION: I began Letter 1036 (February 7) as follows: "On January 25 the Dow closed at 2561.04. The decline took the Dow below its October 13, 1989, crash low of 2569.24, thereby confirming the prior bearish indications of the Transportation Average. Taken together, the action of the two Averages has signaled that a primary bear market is now in force." I haven't changed my opinion. If I had to describe what is going on today, I'd say that the market is forming a huge deceptive top, a top that will not be completed until the high capitalization stocks (and the Dow) enter into a decisive downtrend.

I think the key here is the fact that the Transportation Average topped out last September, and **today, nine months later, the Transports are still 400 points under their bull market high.** So while the eyes of the world are fixed on the rallying or resistant action of the Dow, I believe the Transportation Average is telling the real story. The stock market is marking time -- waiting patiently until the trouble (recession) begins.

VOLUME: Volume indications are difficult to use and can be deceptive. However, it is notable that volume, as the Dow nears or rallies over the 2900 level, drops off dramatically, compared with volume at the 1987 highs or even volume at the 1989 highs. This implies diminished buying interest, a negative sign.

QUESTION: Russell, you say that this is a bear market. But a lot of people are convinced that this is a bull market. So the question is -- can you have a bull market with a rising Dow and many rising large capitalization stocks -- but with a trend of more stocks declining than advancing -- as measured by the advance-decline ratio?

ANSWER: You can have the "appearance" of a bull market as measured by the Dow and large cap averages. But ultimately, either the mass of stocks must enter a rising trend in harmony with the Dow, or the Dow will join the bear market as seen in the majority of stocks.

That's the technical dilemma that is facing the stock market today. However, two factors suggest that the bears will win the game. (1) The flagrant non-confirmation of the Dow on the part of the Transportation Average -- plus the lagging Utility Average. (2) The

chronic price/breadth divergence -- history indicates that price/breadth divergences are usually settled in the direction of the breadth.

DOW THEORY: There is nothing in the market as mysterious and deceptive as the great primary trend of the market. One reason for this is that the stock market loves to disguise its intentions -- and never more so than at major turns.

That's where the Dow Theory comes in, and that's the reason why it has lasted so long. I've been writing these Letters for 32 years, and I can't remember a year when the Dow Theory has not come under attack. Nevertheless, despite 75 years of debate and derision, it is interesting to note that the Dow Theory has outlasted all of its detractors.

The reasons Dow's Theory draws detractors are many fold. (1) First, it does classify the overall trend of the market, and trend classification often interferes with the wishes of Wall Street's analysts. For example, today most Wall Street analysts and gurus are having a very hard time of it. Business is poor and layoffs and cut-backs are the order of the day. Thus, the current bearish market designation (as per Dow Theory) interferes with Wall Street's livelihood. So why not attack the Theory? (Of course, no one attacks the Theory when it calls a bull market.)

(2) Its detractors note that Dow Theory requires interpretation. And that's true. It's also true that not one out of a thousand people have read the great Dow Theory works of Dow, Hamilton, Rhea or Schaefer, so they really know very little about the Dow Theory. It's the old story -- the less the knowledge, the louder the mouth. The nonsense and flagrant misconceptions regarding the Theory are myriad and unending.

(3) The market can be (and usually is) very deceptive at major tops and bottoms. Remember, a bull market (vicious creature) wants to go up with as few investors aboard as possible. And a bear (nasty animal) wants to descend while taking as many optimistic investors with it as possible.

The market is also a frustrated actor, and it loves to disguise itself. The bull wants to look like a bear, and the bear wants to look like a bull. And we, poor investors, usually fall for the act. So at major turns there tends to be confusion and disbelief -- and anger directed at the Dow Theory.

(4) Currently, the disguise that has kept investors bullish, or at least hoping, has been the action of the Dow. Talk of a "3000 Dow" or even "Dow 5000" is still commonplace, and it has all but hypnotized the public and probably most professionals.

Meanwhile, ignored or forgotten is the time-tested Dow Theory thesis which states that a movement of one Average, unconfirmed by the other, is meaningless for predictive purposes and more often than not -- deceptive.

(5) I suppose the hardest thing for the average person (and even for the analysts) to swallow is that the concept of the inevitability of the primary trend. For once the tide turns, the die is caste, and no Presidential promises, no Congressional legislation, no Fed manipulation will undo or reverse the direction of the primary trend of the market.

That concept is denied or disbelieved by most analysts, and it positively drives the politicians up the wall. Of course, in a bull market nobody really wants to know what will halt the upward progress. The sentiment is -- "Just leave it alone." But in a bear market the talk is of "What the Fed should do," "What new laws have to be passed," "What must the President say," or in short -- what buttons have to be pressed in order to turn the tide.

The sad fact is that there are no magic buttons. According to Dow Theory once the primary trend turns up (and a bull market starts), the market will continue irregularly UP until the BEST that can be seen ahead is fully discounted in the price structure. Conversely, once the primary trend turns down (and a bear market starts) the market will continue irregularly DOWN until the WORST that can be seen ahead is fully discounted in the price structure.

Once a bear market starts, TIME works against the stockholder. This is true because in a bear market, values diminish through time. At some point this will become evident in the price structure and in stock quotes as they appear in the newspaper.

Are we nearing that point now? I think so.

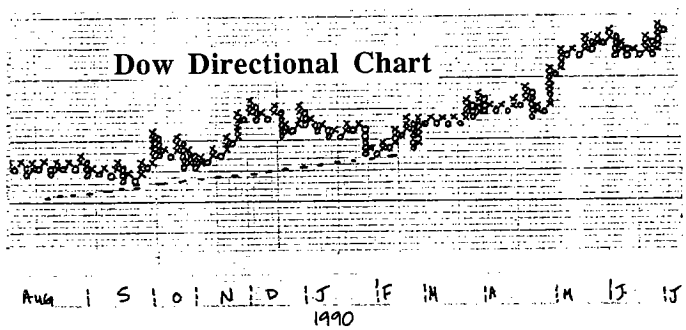
TECHNICAL ITEMS: High-Lows: In a strong market, daily new highs will expand as the Dow rises. In a weakening market, daily new highs will drop off as the Dow pushes higher. In order to clarify the daily high-low picture, I use the 52-week statistics, and I "smooth" the action of the high-lows via a 5-day moving average (MA). When these MA's cross it is usually significant. In fact, some operators trade strictly on the basis of crossings by the 5-day MA's of new highs and new lows.

Over the last year the best the new high index did was 237 last August 2 with the Dow at 2657. The next peak came on October 9 with the new high index at 131 and the Dow higher at 2791. This year in 1990 the peak for the new high index occurred on January 2 at 89 with the Dow at 2810. Finally, the Dow hit its all time high of 2935.89 on June 5. The new high index on that day registered a skimpy 73. Since then the new high index has dropped off into the 40s. In all, a weak, bearish showing with the new low index still above the new high index.

There are two indices which have continued to be bullish. The first is the daily most-active stock index (NYSE). This index traces the plurality of the 15 most active stocks (daily). The index is constructed simply by computing the plurality of the plusses and minuses each day, then adding that figure (be it plus or minus) to the previous day's total.

The daily most-active list shows where the action is, and often (but not always), what the big money is doing. In a strong market, the most-active index will advance persistently, while in a weak market, the most-active index will make little progress or actually decline. There's no question about it -- the most-active index has been strong, and it's been going to new highs week after week. When the bear emerges at its full strength, I would expect this index to enter a long, persistent decline.

The second item of persistent strength is the Dow directional index. This is simply a point & figure chart which moves up one box on each day the Dow rises and moves down one box each day the Dow declines. This index (see accompanying chart) has been in a persistent rising trend for a few years, and it therefore qualifies as one of the very strongest elements of the market.



As I've written in each of the last Letters, the Dow has been the "power sector" of this market. This persistent action can be seen in the profile of the directional chart. It therefore becomes extremely important to monitor this chart and to watch for a reversal. So far, the directional index continues in a definite uptrend. When the bear finally comes out in full force, this index will enter a major downtrend.

SENTIMENT: Sentiment can probably be best summed up by these comments from the June 25 *Christian Science Monitor*:

"There's occasional volatility in the Dow, but within a lackluster trading range. That pattern of ups and downs is apt to continue through June and possibly into fall. Still, the consensus here is that the long range direction for the market -- barring any unexpected shock -- is for the Dow to move past the 3000 mark." Then there are those headlines that frequently serve as contrary opinion classics. The latest could be *Barron's* cover story (June 18) entitled, "Endangered Species: Bears in a Bull Market." Prior to that, in another cover story (June 4), *Barron's* trumpeted, "The Big Boys Still Love That Bull!" Mmmm?

MONEY and RATES: Almost daily we read that the Fed (under pressure from the Administration) is on the verge of lowering money rates. And if a recession appears, we are told, rates will collapse. But people are forgetting that we are now in a global economy. German rates (they are paranoid about inflation) are now higher than ours and Japan (with rising inflation) is considering raising its bank rate again.

If the US lowers rates (regardless of our economy) money will move rapidly into the higher-rate currencies (money is already pouring into the high-rate nations -- Canada and Britain). With massive debts and huge financing on the calendar, US rates will have to stay high. It is interesting that on talk of a tax boost and lower interest rates, gold immediately pushed higher. At even the hint of lower rates, expect the dollar to go in the tank.

INVESTMENT POSITION: As mentioned earlier, there are only two convenient areas outside the US banking system. One is Treasury securities and the other is gold (of course, there are foreign currencies and securities, but they aren't always convenient).

I am opting increasingly for T-bills as an island of safety and I also suggest the monthly accumulation (on a fixed dollar amount) of gold coins. I always like diversification, and along these lines I find a package of Swiss francs and Deutsche marks attractive. The yen bothers me, mainly because Japan is highly leveraged and does not have the conservative bent of either Switzerland or Germany.

The bear continues to reside in the box.

NOTES & QUOTES: I continue to focus attention on the giant US real estate market. This market is one of the KEYS to the US economic situation. We've already seen the disaster set off by the S&Ls. We've seen some of the problems as real estate prices sank in the Northeast and in the Southwest and in Denver and other sundry spots. But we've yet to see an across-the-board coast to coast slide in real estate. If that happened, the insurance companies (with huge mortgages and real estate holdings) would be hurt badly. Remember this: during inflation, the burden of carrying a loan decreases while the value of a real estate asset increases. But during deflation, the burden of carrying a loan increases while the value of the property decreases. That is why deflation (if it arrives) would prove to be an utter horror for the real estate business and for the nation as a whole.

* *

With a one-currency Germany, the new united Germany is almost guaranteed to become THE power of Europe (with Chancellor "King Kohl" the strong man of Europe). Russell adage: "By their currencies, ye shall know them." The mark is already the anchor currency of the nine-nation European Monetary System. Austria, the Netherlands and Belgium have already pegged their currencies to the mark, and the mark is the leading currency in Czechoslovakia and Hungary. Furthermore, East Germany's close link to the Soviets has already made the mark the most important Western currency in the Soviet Union. Finally, the super-powerful Deutsche Bank is conservative and is almost immune to political pressure. Therefore, if Germany starts inflating expect immediate higher rates there. In Germany, *alles ist in ordnung* (everything is in order).

* *

The latest bulletin from the Federal Reserve Bank of San Francisco states, "Given the Bundesbank's staunch anti-inflationary policy stance and past track record, it is doubtful that the German central bank would allow rapid monetary expansion to finance East German reconstruction. The more likely course would be for the increase in demand to drive up German interest rates and the exchange value of the Deutsche mark, reducing business investment in West Germany and the nation's trade surplus, thereby freeing up resources for East German reconstruction."

Question: with Germany increasing her money supply and with Japan's inflation rate and money supply rising sharply, why isn't the dollar stronger? (Last week the dollar index broke to a new low for the year.) Answer: massive US deficits and the fear that the Fed will attempt to lower interest rates.

* *

Have you noticed how Western Gorby-love is cooling off? The reason: Gorby is trying to keep a dead horse alive. The dead horse is the Communist party, and Gorby has attached his star to the party. It's a total dead-end policy, a policy as dead as the Communist party. As far as most people in the Soviet sphere are concerned, the party is simply in the way, it's a nuisance. If Gorbachev insists on making the system work through the party (which he's doing), he'll be history within a year or so.

* *

I'm getting something I haven't seen in years -- *angry letters*. I'm getting letters from subscribers who are angry about this nation's debts, angry about our cowardly Congressmen, angry about Mr. Bush's nebulous waffling, angry about the way this nation is being bought up by foreigners, angry about the S&L fiasco. Although I know that my subscribers tend to be many cuts in intelligence and background above the average American, I do think that their anger is typical of the sentiment in the nation today. Note: the latest bumper sticker states, "Watch Our Lips."

* *

The Bush bombshell flip-flop, the "tax revenue increase" statement, came simultaneously with the end of the US-Japanese negotiations. The so-called agreement stipulates that Japan will greatly boost its domestic spending while the US will address its budget deficit. The Bush announcement was (my guess) prompted by pressure from Japan for the US to seriously address its deficit. Russell comment: With the US on the edge of recession (if we are not actually in recession), you can bet that Congress will do as little as they can get away with, as far as reducing the deficit. Remember, reducing the deficit entails cutting spending, and reducing spending aggravates a recession. Furthermore, talk of increasing taxes in the face of a potential recession is unprecedented.

* *

Who gets what from the coming military cuts? A new study by the NY State Council on Economic Priorities says that the states hit hardest will be Missouri, Arizona and Washington, next most affected will be Texas, Maryland and California. Least affected will be Alaska, Delaware, Hawaii and South Dakota.

* *

A new book is creating a minor sensation. The book is entitled, "The Politics of Rich and Poor" by Kevin Phillips, a Republican guru. Phillips predicts a coming Democratic resurgence based on his thesis that the Reagan years produced pie for the rich and bile for the poor. Maybe, but my own thesis is that in this era of high debt and high interest rates, the division is really between creditors and debtors. Those who have cash are collecting fat incomes in this era of juicy interest rates. And the debtors are paying through their noses via credit cards, mortgages, car financing, etc. Now its debt that's killing the middle and lower classes. And it's fat returns that are lining the pockets of the creditors and those with cash and little debt!

* *

Last year saw the biggest sell-off of US assets in history. The Commerce Dept. just released figures showing that foreigners bought $72 billion worth of US businesses. This was the seventh consecutive year of records. For the decade foreign investments in the US ballooned 636%. As *Insight* magazine puts it, "The Japanese bought Rockefeller Center and Columbia Pictures, the British bought Holiday Inn. And the Dutch bought anything they could get their hands on."

Russell comment: As our debts to foreigners rise, dollars pile up overseas. Much of this has gone into US Treasury debt, but as the US federal debt rises to astronomical proportions, foreigners get a bit queasy about holding all those dollar-denominated bonds. They opt increasingly to put their dollars into US property or businesses (where there is some hedge, presumably, against inflation).

* *

In the *New York Times* on June 23, there appeared a long piece by Jann Wenner (owner of *Rolling Stone* magazine) entitled, "Drug War: A New Vietnam?" Among other things Wenner wrote, "The residents of inner cities don't need more police officers or prison space. They need opportunity and equality. Spend the billions that will result from a drug-peace dividend on education, job assistance, child care and economic development. Legalizing drugs would also eliminate the bloodshed associated with all levels of drug dealing and smuggling. Federal judges would find some 15,000 fewer cases a year on their dockets, which is a small fraction of the burden that would be lifted from state and local courts. And since nearly 50% of all federal prisoners are serving time for drug-related offenses, the national prison crisis would be relieved. Eliminating the black market in illegal drugs would dry up an estimated $50 billion to $60 billion a year in profits for organized crime."

* *

Donald Trump's expenses have been cut to $450,000 a month, this while the banks move toward an orderly sale of the Trump assets (had Trump declared bankruptcy, the courts would have handled the sales). Outside of the $450,000, Trump's other expenses include a 727 jet which costs $246,000 a month and his yacht which costs $841,000 a month. But it's all part of the Trump fantasy, and he has been given the order to sell the both.

* *

Just as the Dow has been "the strength" of the stock market, California real estate has been the strong spot in the nation's real estate picture. In the June 23 issue of the *Economist,* the California real estate picture is questioned. The article entitled "California Dreaming, on a Rainy Day," is sub-titled, "For more than half a century California property prices have been either rising or just about to. With the most recent boom now played out, can the state and its bankers continue to avoid the troubles and bad loans afflicting property markets elsewhere in America?"

The article notes that any cave-in in California's real estate "would be fearsome because California is the motor of the American economy, accounting for around 13% of GNP. Nor are exposures puny. The state's 479 banks, with $19.7 billion of equity capital, had at the end of 1989 $102 billion of California property. California's 154 thrifts not yet under federal control had $270 billion of property loans on equity capital of $16.2 billion.

"California's housing market is cooling. The total stock of new unsold houses in southern California was 6,571 at the end of 1988. Six months later it had nearly doubled to 12,437. . . A bear market in properties always starts with an increasing number of houses for sale."

The *Economist* notes that California's main problem is "affordability." According to the National Assoc. of Realtors' publication which I just received, the affordability rate in San Diego is now 58.2, in LA it's 49.6, in the San Francisco Bay Area it's 51.1, which means that only around 50% of the people in these areas can afford to buy a home. When homes are priced out of the market, either prices come down or more people must come into the area, people who can afford the high costs.

* *

Almost weekly in the *New York Times* or the *WSJ* we read a letter (usually from a college professor or an economist) stating that the deficits don't matter since they are only a small percentage of GNP. To which I say, nonsense. Deficits have to be financed, and financing (I guess the professors don't realize this) requires the sale of bills, notes or bonds.

* *

The Truth About the Deficit: Here's the latest on the US deficit, and you won't read this anywhere else (I guess Washington is afraid to even look at it). The total federal debt is now $3.164 trillion. One year ago the figure was $2.810. Addition to the federal debt (this is the REAL DEFICIT) is an astounding **$354 billion** for those twelve months or $6.8 billion A WEEK. Do you wonder why the bond market is awash with record-breaking Treasury issues?

* *

Increasingly, it appears that the two key world currencies beside the dollar will be the German mark and the Japanese yen. Furthermore, since the Germans and the Japanese have large positive trade balances, they will increasingly take the US' place as lenders and bankers to the world. The world's reserves (i.e., the central banks' reserves) are largely in dollars and gold. But as time goes by my guess is that the yen and the mark will continue to rise in importance. Furthermore, if US finances continue to deteriorate, we might expect nations to opt for fewer dollars and more gold, yen and marks.

* *

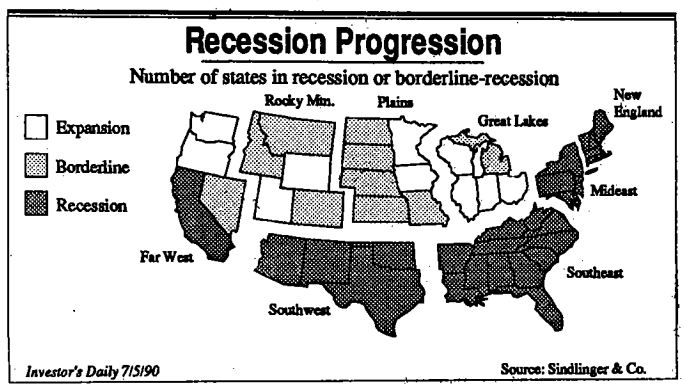
Some wags (or are they just realists?) are saying that there's no longer a two party system in the US. Today it's just the incumbents (them) and us (the us being all the rest of us poor damn souls). Meanwhile, everyone is wondering what the politicians will hatch next. The consensus appears to be taxes, with the emphasis on "tax the rich." Personally, when any new tax is proposed, I always subject it to the acid test. And the test is -- "How will it affect the Congressmen and Senators? If it hurts them, it won't pass " (Note: there are a great many millionaires in both Houses).

* *

A widely publicized study states that today's young (18 to 25) are remarkably disinterested in voting, news, national affairs and world affairs. They just don't care -- the young seem most interested in their own localities and their own pleasures and problems. Russell comment: My feeling is that the average American feels divorced from government and believes that the bureaucracy is so bloated, so inefficient, so corrupt that he can not affect it via voting or anything else. The sentiment is that it's not "my government" any longer, it's "the government -- they."

* *

This chart (courtesy *Investor's Daily*) shows the *Sindlinger & Co.* survey (via random telephone interviews in 48 states). According to the latest *Sindlinger* study, 26 states (in June) were in recession with eleven states in borderline recessions. Who do we believe, Sindlinger or the government?



* *

Gerald Appell (he writes *Systems and Forecasts,* 150 Great Neck Rd., Great Neck, NY 11021) has just returned from an extensive trip to the Far East -- Tokyo, Teipei, Hong Kong, Seoul, Singapore, Bangkok. He writes, "The Japanese are most gracious to visitors, often going far out of their way to be helpful . . . It was sometimes difficult to reconcile this graciousness with the aggressive and often brutal history of Japan . . . Koreans are far less inhibited than the Japanese -- more outgoing when friendly, more overtly angry when they become angry (be careful where you point your camera). The Chinese seem to strike the best balance -- more serious and disciplined than the Koreans, not as rigid as the Japanese. . . It was a little shocking (to an American, at least) to observe the almost total indifference in that part of the world to the machinations of the American stock market. It is quite clear that Japan is the center of economic life in the Far East, not America. It appears quite clear that Asians view their own area as the future -- with hope widespread that mainland China will provide both a ready and inexpensive source of labor as well as a ready market for goods and services created by this labor . . . If I

had to guess I would guess that Indonesia and China offer the best investment opportunities . . . All in all, Asia does seem to be changing, perhaps becoming too Americanized for its own good."

* *

Thoughts in the early morning: Twenty or even ten years ago would I ever have dreamed that I would be here at 3:45 AM, fast-walking on my Precor treadmill while I watch the quotes from the British stock market (via early morning FNN TV, a station, which by the way, provides an excellent view of international markets)?

* *

Why do I get the feeling that the Disney Co. is too damn greedy and wants to cover the world with Epcots and Mickey Mouses (Mice?)? Grouch that I am, I guess I'm the only living Californian who's never been to Disneyland.

* *

I'll admit it -- I'm eager for the new football season to start. With Bobby Beathard as the new Chargers manager, my hopes are up again, for the umptieth time.

* *

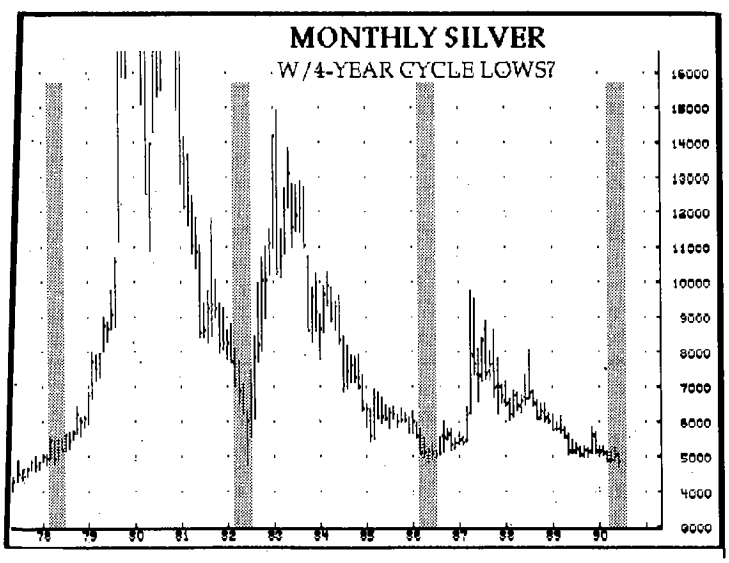
Was there ever a poet as poetic as Samuel Coleridge? Listen to this, from "Kubla Khan" (often considered the most beautiful poem in the English language -- this is the second stanza). Coleridge was an opium addict, but it would take more than opium to write these lines:

I would build that dome in air,
That sunny dome! Those caves of ice!
And all who heard should see them there.
And all should cry, Beware! Beware!
His flashing eyes, his floating hair!
Weave a circle round him thrice,
And close your eyes with holy dread,
For he on honey-dew has fed,
And drunk the milk of Paradise.

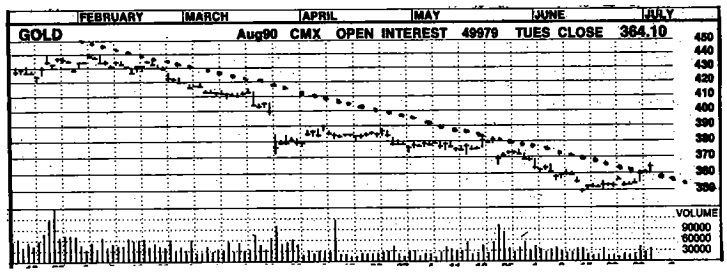
* *

There's nothing as relaxing as watching plants grow. I've built a greenhouse at the back of my home, and it's stuffed with maybe a thousand cacti. When I'm in that greenhouse, I'm in another world -- it's an orderly world where nature rules. And we're redoing the front of our house with desert plantings. People stop, cars slow down, everybody is amazed -- desert plantings in La Jolla in the face of all those green lawns! I tell sightseers that we're just getting in harmony with the environment, that San Diego (in case they didn't know it) is a desert city. People here are still trying to make Southern California look like Connecticut. The only problem is that we're in our fourth year of drought. One more year like this and you can kiss Southern California lawns good bye.

GOLD, METALS: This chart of the silver cycle is interesting, mainly because it shows silver now at or very near the end of its four-year cycle (chart courtesy of *M.J. Capital,* 111 Great Neck Rd., Great Neck, NY 11021). It's hard to conceive of the silver cycle turning up without it exerting upward pressure on gold, so we could be seeing the bottoming and upward turn on the metals at this time. Certainly, the current black-gloomy sentiment towards metals is characteristic of a bottom.



This chart (courtesy of *Investor's Daily*) shows gold breaking above a declining trendline that has been in existence since last February. The reversal of a five-month trendline obviously doesn't guarantee "a new bull market," but it's a first step in breaking the downward momentum.

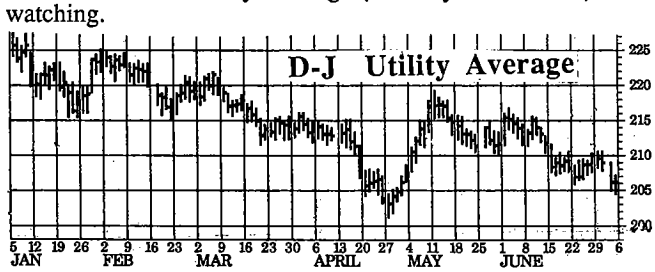


In today's *WSJ* there was a piece explaining that gold has not been a good "investment". The writer doesn't understand gold. Gold isn't an investment, gold is pure money. It's what's left when everything else is bankrupt -- it's what you can leave your great-great-grandchildren with the sure knowledge that this gift will still have purchasing power.

LATE NOTES: Aside from my old buddy Harry Schultz, David Fuller writes probably the most international of all market letters (*Fuller Money*, 7 Swallow St., London, WIR 7HD UK). I always look forward to what David has to say, and in his latest report he writes, "These are hard times for market pundits. A few indicators hit new highs, but are offset by others at new reaction lows. A majority of these moves are not being maintained, resulting in both failed upside and downside breaks. It's a whipsawing environment . . . Some analysts have stopped forecasting stock market trends, while others give extreme ranges, such as a blow-off to be followed by a collapse. This view is particularly fashionable on Wall Street . . . I expect more rallies to fail without a sustained lead from bond markets. If bonds continue to range in base formations, as I suspect, high real interest rates will undermine corporate profits in many countries. That is the background for a fundamentally based bear market in global equities."

I wouldn't argue with the above analysis. The Utility Average is particularly sensitive to interest rates, and this Average is now proving to be stubbornly resistant to advances -- even on days when the Dow is strong. On weak days the Utility Average gets hit -- hard. Is the Utility Average telling us something about forthcoming interest rates? My feeling is that it is (higher rates would be contrary to the almost universal opinion that rates are now too high and must go down).

This chart of the Utility Average (courtesy of the *WSJ*) is worth watching.



LATE NOTES: Due to a long spate of poor breadth figures, the market has moved into oversold status. Reflecting this, the Dow continues to rally (or at least tries to rally). But volume holds to low levels (signifying lack of participation), bonds are weak, and the persistent downtrend in Utilities is particularly ominous. The market is beginning to see the endless, record-breaking torrent of Treasury financing coming up. As I see it, the dominant forces on the stock market are fast becoming debt and interest rates. But the full impact of these two has not been seen yet.

NEXT MAILING: July 25